

LEGAL LENDING LIMIT TREATMENT FOR PARTICIPATION AGREEMENTS CONTAINING REPURCHASE OPTIONS

**OFI Advisory Opinion No. 1
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Purpose

This advisory opinion is to clarify the application of Louisiana Banking Law (LBL) to a standard non-recourse loan participation agreement that contains the phrase: *"The Originating bank shall have the right, at its sole and exclusive option, to repurchase the participating bank's ownership interest in the loan at any time."* Because the agreement contains a repurchase option, the selling institution may not book such a transaction as a sale under Generally Accepted Accounting Principles (GAAP) and Call Report instructions, even though the transaction is on a "nonrecourse" basis. Institutions must report such transactions as secured borrowings and continue to report the gross amount as a loan.

Issue

If an institution must report the entire amount of the loan on its books as if it had not sold an interest in the loan and the total dollar amount exceeds the institution's legal lending limit, is there a violation of LBL? Does the acquirer of an interest in a loan own a portion of the proceeds from the loan if the seller has an option to repurchase the amount sold?

Analysis

Regardless of the manner in which the transaction must be reported under GAAP, the answer depends on whether the transaction is a sale or a borrowing under Louisiana Contract Law. A Louisiana court held that the acquirer owned a portion of the proceeds, i.e., the transaction was a sale rather than a borrowing, because the transaction included the following:

1. Although the sales agreement provided the seller an option to repurchase the interest in the loan sold to the acquirer, the agreement did not **require** the seller to repurchase the interest; and
2. The parties to the agreement shared not only in the benefits of the agreement but also in its risks.

Conclusion

When loan participations are sold which meet the above conditions, the portion sold is not considered to be a borrowing and will not be used in the computation for compliance with the legal lending limit.

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